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Report On Business

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Purchasing Index Recovers to 54.4%

New Orders Continue Strong

Employment Improves

Analysis by the Business Survey Committee; chairman, Robert J. Bretz, C.P.M., director of purchasing and distribution, Pitney Bowes, Inc.

The *Report on Business* is published monthly by the National Association of Purchasing Management, based on data compiled from replies to questions asked of purchasing managers in some 250 industrial companies. Membership of the Business Survey Committee is diversified geographically, based on value added by state, and by Standard Industrial Classification category, based on each industry's contribution to national income.

May Report

Rebounding from a slow April, the economy improved in May, say the nation's purchasing managers in their latest **Report on Business.** While production levels were slightly lower, new orders maintained the strength registered in the previous four months, and were even more impressive considering seasonal adjustment factors. Most important, the Purchasing Managers' Composite Index was up dramatically to 54.4%. Employment, weak in April, increased in May. The speed of vendor deliveries was unchanged, but inventories increased for the first time since February. For the eighteenth consecutive month, prices were reported the same or lower. However, in May the gap narrowed between those reporting higher prices compared to lower.

"The economy definitely improved in May. Virtually all indicators were up, with new orders leading the way. If this trend continues, the second quarter should show a healthy improvement over the first," said Robert J. Bretz, C.P.M., chairman of the National Association of Purchasing Management's Business Survey Committee and director of purchasing and distribution, Pitney Bowes, Inc.

The **Purchasing Managers' Composite Index** increase to 54.4% represents a quick recovery from the 48.7% registered in April (which was the first fall below 50% after seven consecutive months of being over that mark). A reading above 50% generally indicates that the economy is in an expanding phase: below 50%, that the economy is generally declining. The index is based on analysis by the U.S. Department of Commerce. Except for this index, the information in this report is not seasonally adjusted.

Net Difference

In each category measured, this report shows a net difference. It is the difference between the number of responses in the positive direction (higher, better, faster) and the negative direction (lower, worse, slower). Analysis of the month-to-month difference compares the rate of change.

Employment

Employment improved in May, while still remaining depressed. The 17% of members reporting lower employment levels is down from 22% in April, and is the lowest percentage reported since September 1984 (14%).

Employment %	Higher	Same	Lower	Net Differ.
May	13	70	17	– 4
April	14	64	22	– 8
March	11	71	18	– 7

Buying Policy

The improvement in the economy in May apparently did not cause purchasers to lengthen lead times. Those who reported hand-to-mouth buying of production materials rose to 21%, up from 16% in April. MRO supplies are also in adequate supply as 44% of members reported purchasing hand-to-mouth, an increase from 41% in April. For the first time since February 1985, nobody had lead times of six months or longer for MRO supplies. In capital expenditures, lead times expanded only slightly, with 10% reporting lead times of 30 days compared to 4% last month.

Production Materials %	Hand to Mouth	30 Days	60 Days	90 Days	6 Months and Longer
May	21	40	26	7	6
April	16	46	22	10	6
March	15	45	28	5	7
MRO Supplies %					
May	44	46	7	3	0
April	41	46	9	1	3
March	41	50	6	1	2
Capital Expenditures %					
May	16	10	4	16	54
April	17	4	5	21	53
March	15	6	6	18	55

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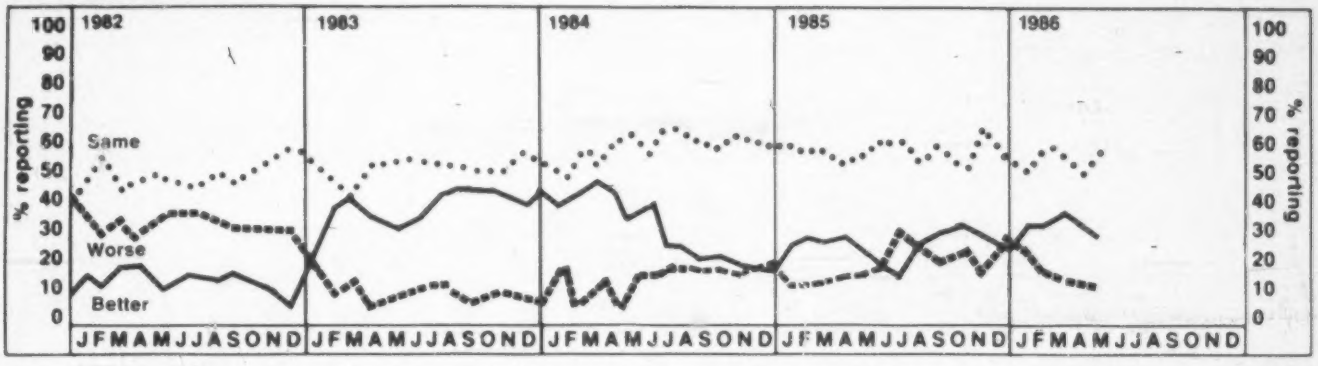
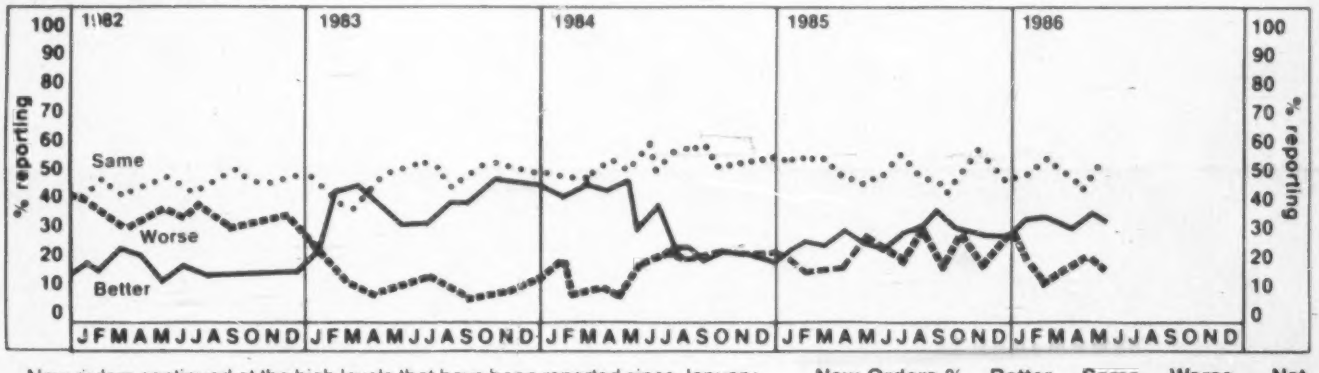
Production



Production was off slightly in May. However, if seasonal adjustments are considered, production improved from the slow pace of April.

Production %	Better	Same	Worse	Net
May	28	56	16	+12
April	32	50	18	+14
March	35	53	12	+23

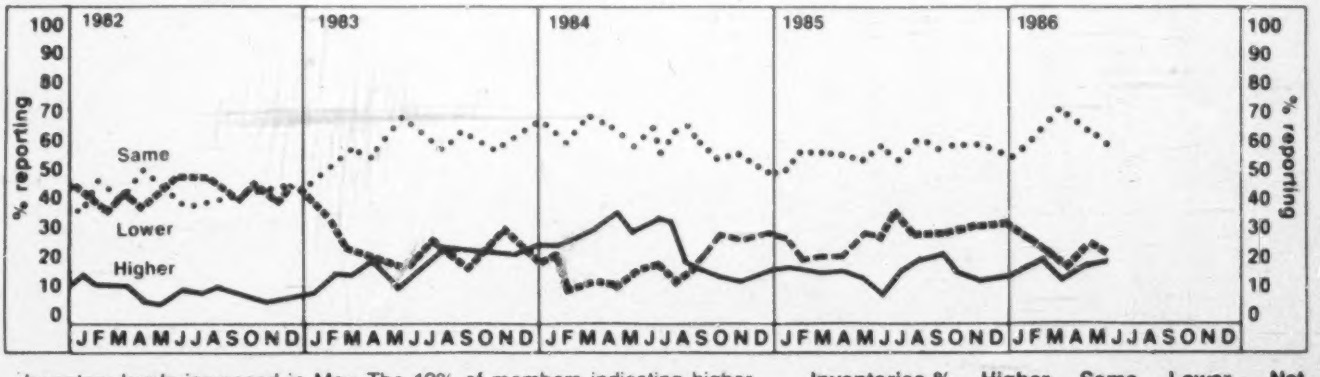
New Orders



New orders continued at the high levels that have been reported since January 1986. After considering seasonal adjustments, May is the strongest month to be reported in the past two years. This level suggests a relatively good June and could mean an overall better second quarter.

New Orders %	Better	Same	Worse	Net
May	34	51	15	+19
April	37	45	18	+19
March	33	53	14	+19

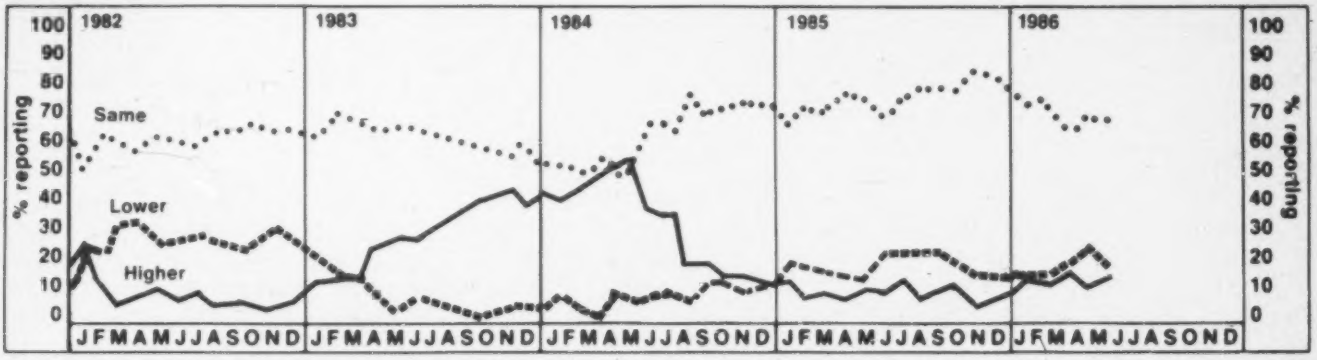
Inventories



Inventory levels increased in May. The 19% of members indicating higher inventories for the month is the highest percentage since January 1985 (also 19%).

Inventories %	Higher	Same	Lower	Net
May	19	59	22	− 3
April	14	62	24	−10
March	11	70	19	− 8

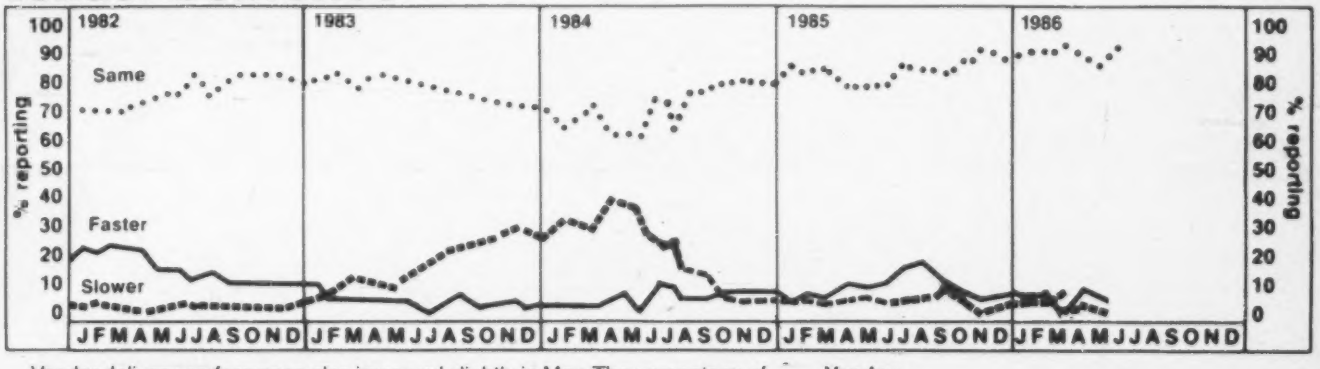
Prices



Although more members continued to say that prices are lower rather than higher, for the second time in three months, purchasers reporting higher prices reached a level not seen since September 1984 (19%). The total in May was 16% and in March it was 17%. While oil prices continue to decline, except for energy-related products, there is little indication that price reductions for by-products have flowed through to purchasers.

Prices %	Higher	Same	Lower	Net
May	16	67	17	− 1
April	11	68	21	−10
March	17	66	17	0

Vendor Deliveries



Vendor delivery performance also improved slightly in May. The percentage of purchasers reporting the speed of their vendors' deliveries as being the same or faster was 98%, compared to 95% in April. Only titanium dioxide was reported difficult to obtain.

Vendor Deliveries %	Faster	Same	Slower	Net
May	4	94	2	+ 2
April	5	88	7	− 2
March	1	92	7	− 6

Specific Commodity Changes

Only one item, corrugated shipping containers, was reported up in price in May. Energy products led the list of items reported lower in price. These included fuel oil, gasoline, and miscellaneous petroleum products, all reported as lower in price for the fourth consecutive month. Caustic soda was reported down in price for the tenth consecutive month; phenol prices were lower for the second consecutive month. Copper was reported lower in price for the first time since November 1985, and cocoa prices were also reported lower. Titanium dioxide was once again in short supply, as it was in March 1986. It is the only item to be reported short in the last sixteen months.

UP in Price: Corrugated shipping containers

DOWN in Price: Fuel oil, gasoline, miscellaneous petroleum products, phenol (used in plastic resins for housing and auto products), copper, caustic soda (used heavily in petroleum refining and paper making), and cocoa

In SHORT Supply: Titanium dioxide (a lead-free pigment used heavily as a whitener in coatings and other industrial applications)

The National Association of Purchasing Management's *Report on Business* records the actual changes and rates of change in five important categories of data: production, new orders, employment, inventories and vendor deliveries. These five components, as reported, are not adjusted to compensate for seasonal variations.

Economists have devised a variety of formulas to compensate data for seasonal variations. N.A.P.M. cooperates with the U.S. Department of Commerce, which prepares the monthly Purchasing Managers' Composite Index for publication by N.A.P.M. The Department of Commerce adjusts the five above-mentioned components of the *Report on Business*, applies various weights to each and combines them into a single index number. The Composite Index is based on analysis by the U.S. Department of Commerce, and is the only part of the report adjusted for seasonal variations.

Note: The next issue of the *Report on Business* will be available July 7, 1986.

Commodity Reports

Energy

Prepared by the N.A.P.M. Energy Committee; chair, Howard T. Perley, C.P.M., International Paper Company, New York, NY.

Petroleum Products

The price "crash" that has threatened for three years has happened; supply and demand are finally determining the market price of crude oil. Instead of supporting prices by limiting its output, Saudi Arabia restored production to its OPEC ceiling. "Net-back" pricing arrangements allow refiners to maintain their margins at any production level. As a result, gasoline prices dropped sharply; No. 2 fuel oil prices should average thirty cents per gallon less than last year's prices. In many areas, residual fuel oil can now compete effectively with natural gas used by electric utilities for summer cooling and by large industrial boilers. (J.H. Kedrowski, Aluminum Company of America, Pittsburgh, PA)

Natural Gas

Intense competition and the collapse of oil prices have forced down gas prices, and they are expected to stay low for the rest of 1986. Buying gas directly from producers can reduce costs further if the pipelines involved will transport it. Low prices have reduced gas drilling to the lowest level in over thirteen years, so shortages may reoccur in several years. (Ian G. Mackenzie, C.P.M., Corning Glass Works, Corning, NY)

Coal

Although utility stockpiles are now lower and coal sales may increase, the coal market is expected to continue to soften as natural gas and fuel oil prices decline. The Black Lung Excise Tax increased 10% on April 1, but producers will have trouble passing it along in their spot prices. Spot purchases should still be favored over long-term contracts, and efforts should be made to negotiate lower transportation rates. Users should also follow current acid rain legislation and its potential impact on sulfur content restrictions. (W.T. Robertson, Jr., C.P.M., Duke Power Company, Charlotte, NC)

Electric Power

If summer demand stays relatively normal, most utilities' generating capacity should remain plentiful except on abnormally hot days. Industrial users should explore the possibility of shifting their loads to off-peak periods if their utility offers lower-cost interruptible or off-peak "economy" power. Nevertheless, the effect of the Soviet nuclear accident on power supplies should be watched carefully; added steps to improve safety may cause production cutbacks at U.S. nuclear plants.

Steel

Prepared by the N.A.P.M. Steel Group; chair, Daniel E. Krause, The Budd Company, Troy, MI.

The outcome of labor negotiations could well establish the form and vitality of the U.S.A. steel industry of the future. The involved mills (well aware of competitive demands) will be asking for wage and fringe concessions as well as major changes to work rules. The union leadership will insist on strengthened job security and profit sharing opportunities to convince their members to accept some (at least in part) of the concessions the mills want. Settlements appear to be likely between the companies and the union; the companies are financially troubled, and the union's membership is at its lowest level since 1933. If a settlement should not happen, other options still exist, such as mill closings, sales of facilities, and restructurings and reopenings under new names with new owners.

Seasonal demand and strike-hedge preparation have lengthened lead times on all products except heavy plate. This situation would be much worse if the government's Voluntary Restraint of Imports program had been more effective. Imports still total 26% of consumption, which is only slightly below 1985 levels and far above the intended 21% limit. Even without lower imports, longer lead times should persist until new labor contracts are signed.

Overall, 1986 should be a slightly better year for the steel industry than were the previous two years. The mills appear to be successful in recovering part of the 6% to 6.5% price discounts of 1985. Productivity continues to increase with the addition of new casters, improved quality, and downsizing of the workforce. The predicted decrease in demand for the second half of 1986 may not fully materialize as the full effects of lower oil prices and the weaker dollar stimulate the economy, and as lower imports are felt. Still; at best, it has been a break-even year for the domestic mills with no strong indications that the struggle for survival is yet over. The alert steel buyer will continue to search for opportunities to contain steel prices through 1986. (N.E. Candell, Caterpiller Tractor Company, Peoria, IL)